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IN THE

Supreme Court of the United States

OCTOBER TERM—1946

No. 1275

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

—*against*—

ALFRED INVESTMENT TRUST, et al.,

Defendants.

Application of Frank Bailey, et al.,

Intervenors-Petitioners,

for an Order terminating the Receivership, etc.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT, AND SUPPORTING BRIEF.

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Application of Frank Bailey, et al.,

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for an Order terminating the Receivership, etc.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT, AND SUPPORTING BRIEF.

To the Honorable The Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, by Samuel H. Kaufman, their attorney, pray that a writ of certiorari issue to review a judgment of the United States Circuit Court of Appeals for the First Circuit, rendered February 24, 1947. That judgment affirmed a judgment of the United States District Court, District of Massachusetts, which, insofar as here material (1) denied petitioners' application to terminate the receivership of Aldred Investment Trust and, instead, ordered the

receivers to liquidate it, and (2) denied petitioners' application to call a special meeting of the security holders of Aldred for the purpose of electing new trustees to supersede those who had been enjoined from continuing to act because of their gross abuse of trust.

Jurisdiction.

The basis of jurisdiction is Section 240 of the Judicial Code.

Summary Statement of Matters Involved.

Aldred is a Massachusetts Trust, organized in 1927 under an "Agreement and Declaration of Trust". It is registered with the S. E. C. pursuant to Section 8 of the Investment Company Act of 1940 as a "closed end" management investment company. Aldred has $5,900,000 of 4½% debentures due 1967 outstanding. To each $1,000 debenture are attached ten shares of common stock without par value. In addition, Aldred has 112,500 "free" common shares, so that altogether 171,500 shares are outstanding. Aldred's "Agreement and Declaration of Trust" vests complete management and investment discretion in its trustees, who are to be elected by the stockholders.

In October 1941, Gordon B. Hanlon and his associates obtained stock control of Aldred by the purchase of 110,000 shares of the "free" stock, and they proceeded to elect Hanlon President, and his associates as the other officers and Trustees, of the Trust.

On May 19, 1944, the S. E. C. commenced the instant proceeding under Sec. 36 of the Investment Company Act of 1940, charging Hanlon and his associates with "gross misconduct and gross abuse of trust" within the meaning of that Section, to enjoin them from continuing to serve as officers and trustees, and for the appointment of a receiver.

The learned District Court found Hanlon and his associates guilty as alleged in the complaint, and enjoined

them from continuing to act (58 Fed. Supp. 724). Although the learned Court, in its Conclusions of Law, directed that receivers be appointed (R. 49).

> "with power either to reorganize the capital structure of the Trust or liquidate the Trust and distribute the assets",

the decree entered thereon authorized the receivers only to operate the Trust, and contained no authorization or direction to reorganize or liquidate (R. 26).

The Circuit Court of Appeals affirmed the judgment of the District Court (151 F. (2d) 254) and this Court denied Hanlon's petition for certiorari (326 U. S. 795).

While the Trust was in receivership petitioners, by purchase, acquired all the stock theretofore owned by Hanlon and his associates. They also purchased $79,000 of the debentures, to which are attached 790 shares of stock, thereby making petitioners the owners and holders of approximately 65% of the issued and outstanding stock of the Trust. They have intervened herein pursuant to order of the Court (R. 52).

Petitioners had, and have, no connection with Hanlon or any of his group; their purchases of the stock and debentures were bona fide, and Hanlon and his associates have long since ceased to have any interest in the Trust or any participation, direct or indirect, in its management.

As the result of the sale by the receivers of certain of the securities which were in Aldred's portfolio, and appreciation in the value of others, Aldred now has assets having a marketable value in excess of $8,500,000, as against a total liability on its debentures of $5,900,000, and no other debts except the expenses of this proceeding.

The stockholders of the Trust are, without dispute, prepared to elect new officers and trustees who are in all respects reputable and competent to manage the affairs

of the Trust, if only the Court would grant their application for leave to meet and hold an election.

On the grounds that the Trust is now fully solvent, is completely rid of the corrupt management which was the basis of the receivership, and has competent and reputable management available, petitioners moved to terminate the receivership and to restore the Trust estate to its beneficial owners.

That application was denied by the learned District Court, and the receivers were directed to liquidate. The judgment was affirmed by the Circuit Court of Appeals.

Although the Act authorizes the Court to decree liquidation in certain types of cases which the S. E. C. is authorized to bring under the Act, it confers no such power in actions under Sec. 36. On the contrary, the Act expressly provides that if the allegations of the complaint in an action under Sec. 36 are established, the Court shall issue an injunction prohibiting the recreant officers and trustees from continuing to serve. The Courts below have held, however, that notwithstanding the foregoing provision of the Act, the District Court had power to decree liquidation in this action under its "general equity powers".

Petitioners seek leave, by this application, to review (1) the power of the Court to order liquidation in a case of this kind, and (2), if power exists, the propriety of such an order in the circumstances of this case.

While the Trust was in receivership, petitioners moved for an order permitting them to call a special meeting of shareholders of the Trust, in accordance with the Agreement and Declaration of Trust, in order that the beneficial owners of the Trust might elect new trustees to the offices left vacant by the removal of the former ones, and to permit the security-holders to determine the future policy of the Trust. This application was denied by the District Court. The learned Circuit Court of Appeals, though apparently

recognizing the error, has held that the question was rendered "moot" by the order of liquidation and, in any event, that the error was "harmless" because petitioners owned over 50% of the stock and were permitted to present their "views" to the Court.

Petitioners, by this application, seek leave to review that determination.

The Questions Presented.

1. Has the Federal Court, in a suit brought by the S. E. C. pursuant to Section 36 of the Investment Company Act of 1940, the power to direct liquidation of a registered investment company?

2. Even if such power exists, was it proper for the Court to direct liquidation in the circumstances of this case, i.e. where, during the receivership and prior to the order of liquidation, the Trust had become solvent, the former management, because of whose corruption receivers had been appointed, had been ousted, and undisputedly capable, efficient and reputable management is available and prepared to take over the administration of the Trust?

3. Was it proper for the Court to deny petitioners' application for an order calling a meeting of stockholders of Aldred to elect new trustees? If not, was it proper to disregard the error for the reasons stated by the Circuit Court of Appeals i.e., because the order of liquidation rendered the question "moot", and because petitioners, the owners of a majority of the stock, were "engaged in presenting their views to the Court"?

The Reasons Relied on for the Allowance of the Writ.

1. The S. E. C. is empowered to bring suits upon a variety of grounds. This power derives from the Act, and

is purely statutory. In certain cases the Act provides that if the charge is proved, the Court shall issue an injunction; in others, that the Court shall direct liquidation; and in still others, that the Court may impose penal sanctions. The type of action here involved—against corporate officers and trustees for "gross abuse of trust"—is authorized by Sec. 36 of the Act, and that Section expressly provides that if, in such an action, the charges are proved, the Court shall grant an *injunction prohibiting the recreant officers and trustees from further participation in the corporate activities.* The Court below, in disregard of this statutory remedy for a purely statutory cause of action, has decreed *liquidation of the corporation.* Thereby, we submit, the Court committed error, and reached a conclusion in conflict with decisions in this Court and in other circuits. The case is governed by two principles; first, *expressio unius exclusio alterius,* and second, where a right to sue is created by statute, and the statute prescribes the remedy, that remedy is exclusive.

2. Even if the Court had the power to liquidate, it was error to order liquidation in the circumstances of this case because the management, for whose faithlessness receivers were appointed, has been removed, the Trust is amply solvent, and honest, competent management is prepared to administer it.

3. Aldred was placed in receivership because its management was corrupt and wasteful. The reasons for which receivership was required no longer exist. Since the Trust now has available to it honest, capable management, the Court should have granted petitioners' application to terminate the receivership and restore the property to its beneficial owners.

4. It was error to deny petitioners the right to call a meeting of security holders to elect new trustees. This right is not cut off by receivership. The denial of it was prejudicial because without such leave the meeting could not be called, inasmuch as the receivers alone had a list of the security holders and they refused to make it available to petitioners. Communication among the security holders, to ascertain their views, was thereby frustrated.

POINT I.

In ordering liquidation under its "inherent equity power" the Court was in error and in conflict with decisions in this Court and in other circuits. The Act authorizes liquidation in only two specified types of cases, of which this is not one, and expressly provides that in cases of this type the remedy shall be an injunction. Since the right of the S. E. C. to sue is created by the Act, and the remedy is defined in the Act, that remedy is exclusive. The Court may not ignore the limitation imposed by the Act and, under its "general equity power", decree relief not authorized by the Act.

The Act authorizes the S. E. C. to bring actions and instigate proceedings to enforce compliance with the Act or punish violations thereof (Sec. 42). The relief which may be granted is specified in the Act and varies with the nature of the act or omission complained of. In certain cases, the Court is authorized to grant an injunction [Secs. 36, 42(e)]; in others it may decree liquidation, (Sec. 42(e)), and in still others it may impose penal sanctions (Sec. 49). In only two types of cases—and the language of the Act is very specific—may liquidation be directed. These two cases are (a) suits based on violations of Section 7 of the Act, requiring registration as a condition precedent to selling corporate securities in interstate commerce (Sec. 42(e)); and (b) actions to protect the interests of security

holders in "Unit Investment Trusts" (Sec. 26(e)). Thus Section 26(c) provides, under the title "Unit Investment Trusts" that

> "Whenever the Commission has reason to believe that a unit investment trust is inactive and that its liquidation is in the interest of the security holders of such Trust, the Commission may file a complaint seeking the *liquidation* of such Trust in the District Court of the United States * * *. If the Court determines that such liquidation is in the interest of the security holders of such Trust, *the Court shall order such liquidation* and, after payment of necessary expenses, the distribution of the proceeds to the security holders of the Trust in such manner and on such terms as may to the Court appear equitable." (Italics ours.)

Again, in Section 42(e) of the Act, under "Enforcement of Title" we find this:

> "In any proceeding under this subsection to enforce compliance with Section 7 [the section dealing with registration] the Court as a Court of Equity may, to the extent it deems necessary or appropriate, take exclusive jurisdiction and possession of the Investment Company * * *; and the Court shall have jurisdiction to appoint a trustee, who, with the approval of the Court, shall have power *to dispose of any or all of such assets*, subject to such terms and conditions as the Court may prescribe". (Italics ours.)

The present action is not a proceeding under Section 7 and Aldred is not a unit investment Trust. Consequently, neither of the provisions quoted above has any application here. This is an action under Section 36 to enjoin officers and trustees from continuing to act, on the ground that

they have been guilty of "gross misconduct and gross abuse of trust", within the meaning of that section, which provides:

> "The Commission is authorized to bring an action in the proper District Court of the United States * * * alleging that a person serving or acting in one or more of the following capacities [including officer or director] has been guilty * * * of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts * * * if the Commission's allegation of such gross misconduct or gross abuse of trust are established, *the Court shall enjoin such person* from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate." (Italics ours.)

This specification of the remedy of injunction in such cases, and the clear indication that liquidation may not be ordered in such cases, is further manifested in Section 42(e) of the Act under the heading "Enforcement of Title", where it is provided that if it appear to the Commission that any violation of the Act has been committed, the Commission may bring an action in the United States District Court,

> "*to enjoin such acts* or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, *a permanent or temporary injunction* or decree, or restraining order shall be granted without bond." (Italics ours.)

It is immediately following this provision of Section 42(e) that Congress has provided for a specific exception, i.e.,

that in a proceeding *to enforce compliance with Section 7*, relating to registration, the Court

> "shall have power to dispose of any or all such assets, subject to such terms and conditions as the Court may prescribe."

Thus the question of liquidation was distinctly in the mind of Congress; yet in the very section (42) in which it authorized liquidation in a proceeding under Sec. 7, it limited the relief in actions under Sec. 36 to injunction, and this limitation is expressed in Sec. 36 itself.

If Congress had intended the Courts to have power to liquidate in all cases under the Act, there would be no reason or purpose in expressly granting the power in cases involving unit trusts or violations of the registration provisions of the Act, or in providing in Sec. 36 that in cases brought under that section the remedy shall be an injunction. The express provisions for liquidation in specific cases, of which this is not one, coupled with the specific provision for only an injunction in the case of an action pursuant to Section 36, would seem to leave no doubt that Congress not only did not provide for liquidation in cases under Section 36, but that it deliberately excluded any such remedy in cases under that section.

It must be kept in mind in the consideration of this case that we are dealing here with a statute which creates the right to sue and prescribes the remedy, and that in such a case the remedy provided in the statute is exclusive:

> *Pollard* v. *Bailey*, 20 Wall. 520 (1874);
> *U. S.* v. *Smelser*, 87 F. (2d) 799 (C. C. A. 5th, 1937).

In *Globe Newspaper Co.* v. *Walker*, 210 U. S. 356 (1908), Mr. Justice Day, writing for this Court said p. 365):

> "The general rule applicable in such cases was stated in Pollard v. Bailey, 20 Wall. 520:
>
> > 'A general liability created by statute, without a remedy, may be enforced by an appropriate common-law action, *but where the provision for the liability is coupled with the provision for a special remedy that remedy, and that alone, must be employed.*'
>
> Pollard v. Bailey has been many times cited with approval and followed in this court." (Italics ours.)

In the *Smelser* case Circuit Judge Holmes said, 87 F. (2d) 799, 801 (C. C. A. 5th, 1937):

> "Since the right to sue is created by statute, and is coupled with a remedy which is prescribed in the same act, the remedy thus prescribed in conjunction with the right is exclusive, and must be followed."

The fact that Congress has not conferred on the Court the power to liquidate in a proceeding brought by the S. E. C. under Section 36 does not mean that the Courts have been divested of the right, in a proper case, to decree liquidation; it means only that the right to liquidation has not been *extended* to include cases of this character brought by the S. E. C., but leaves the right in full vigor in all cases in which it existed before the Act was passed.

The only right given to the S. E. C. to sue in cases based on "gross misconduct or gross abuse of trust" is the right created by Section 36, and by that very section, as well as by Section 42, the remedy is fixed and limited to an injunction. Congress clearly intended that in such cases the corporation should continue in existence and the beneficial owners of the property should be permitted to supply new officers in the place of those enjoined from acting.

We reach the same conclusion by another approach.

This Court has held, in *In re Heath*, 144 U. S. 92 (1892), that the affirmative description of the instances in which power may be exercised implies a negation of the power in other instances. More recently this Court said, in *Continental Casualty Co.* v. *United States*, 314 U. S. 527, 533 (1942):

> "Generally speaking, a 'legislative affirmative description' implies denial of the non-described powers. *Durousseau* v. *United States*, 6 Cranch 307, 314."

See also *Botany Worsted Mill* v. *United States*, 278 U. S. 282 (1929); *S. E. C.* v. *Long Island Lighting Co.*, 148 F. (2d) 252 (C. C. A. 2nd, 1945); *Martin* v. *Commissioner of Internal Revenue*, 61 F. (2d) 942 (C. C. A. 2nd, 1932), cert. den. 289 U. S. 737 (1933); *Fidelity & Casualty Co. of N. Y.* v. *Allen*, 84 F. (2d) 53 (C. C. A. 7th, 1936).

The rule is, of course, subject to reasonable interpretation. Where a statute contains, in addition to certain enumerated powers, a general grant of power, the general grant will be given full effect if the context shows that the enumeration was not intended to be exclusive. *Continental Ill. Nat. Bk. & Trust Co.* v. *Chicago R. I. & P. Ry. Co.*, 294 U. S. 648, 677 (1935); *Springer* v. *Philippine Islands*, 277 U. S. 189, 206 (1928). And the Court may decide whether it was the Congressional intent to include a particular power where the specific powers authorized are ambiguous. *Crancer* v. *Lowden*, 121 F. (2d) 645, 649 (C. C. A. 8th, 1941).

In the Investment Company Act there is no general grant of the power to liquidate, and there is no conceivable ambiguity. The statute clearly provides that a closed-end investment company, such as Aldred, may be ordered liquidated if, without registering, it does any of the things enumerated in Section 7. No violation of Section 7 is, or

could be, asserted in this case. The general power of a court to order liquidation is limited to *unit* investment trusts. There is no room for even a contention that Aldred is a unit investment trust, and no such contention is made.

Liquidation is universally recognized as a drastic remedy, to be decreed only in exceptional situations, and whenever it is the intent of Congress to confer the power to liquidate, it does not leave the existence of the power to inference, but expressly and specifically grants it. See, for example, the Bankruptcy Act, 11 U. S. C. A., Sec. 11; the Federal Home Loan Bank Act, 12 U. S. C. A., Sec. 1446; the Foreign Banking Corporations Act, 12 U. S. C. A., Sec. 623; the Home Owners Loan Act, 12 U. S. C. A., Sec. 1463(k); the Savings & Loan Act, 12 U. S. C. A., Sec. 1729; the National Mortgage Association Act, 12 U. S. C. A., Sec. 1720; the National Agricultural Credit Corporations Act, 12 U. S. C. A., Sec. 1303; the Federal Savings and Loan Associations Act, 12 U. S. C. A., Sec. 1729.

The Public Utility Holding Company Act, 49 Stat. 834, 15 U. S. C. A., Sec. 79 affords an example of a statute in which Congress intended to authorize liquidation under specified conditions. Section 11(b)(2) of that Act provides that the Commission shall require each registered holding company to take such action as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure of the system or inequitably distribute the voting power among security holders. Section 11(d) empowers the Commission to apply to a court to enforce compliance with the foregoing, and in such a proceeding

> "the court *as a court of equity* may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and posses-

> sion of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee * * * In any proceeding for the enforcement of an order of the Commission issued under Subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets. * * *" (Italics supplied.)

This provision, it will be noted, is similar to Sec. 26(c) of the Investment Company Act, relating to proceedings in reference to unit investment Trusts, and entirely different from Sec. 36, relating to suits to enjoin officers and trustees because of "gross misconduct and gross abuse of trust". If the power of a District Court to liquidate derives from its "general equity powers", why the enactment of Section 11d of the Public Utility Holding Company Act, or the analogous provisions of the other statutes cited?

In *American Power & Light Company* v. *Securities and Exchange Commission*, 329 U. S. 90 (1946), affirming 141 Fed. (2d) 606 (C. C. A. 1st, 1944), this Court had before it the validity of orders requiring the submission of plans for liquidation under Sections 11(d)(2) and 11(d) of the Public Utility Holding Company Act. The contention was made by the petitioning companies that compulsory involuntary liquidation could be effected "only through the exercise of the bankruptcy power". This Court found the orders valid by reason of the specific *legislative grant of authority* in the Public Utility Holding Company Act and that "the Commission's actions conform to the statutory language and policy." The Court recognized that in the Public Utility Holding Company Act the legislative grant of the power to compel liquidation bore a real and substantial relation to the objects to be attained, namely, the protection of interstate commerce from various harm-

ful effects which may be anticipated as likely to flow from the undue complexities and inequitable distribution of voting power in the holding company systems. See also *Commonwealth & Southern Corporation* v. *Securities and Exchange Commission*, 134 Fed. (2d) 747, 753 (C. C. A. 3rd, 1943); *North American Company* v. *Securities and Exchange Commission*, 133 Fed. (2d) 148, 154 (C. C. A. 2nd, 1943); *Nebbia* v. *New York*, 291 U. S. 502, 527 (1934); *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555 (1935).

If the power to liquidate is inherent in the equity powers of the Court, it is difficult to understand the necessity for resting the decision in the *American Power & Light Company* case and the other cases cited upon a specific statutory grant of power.

In support of its conclusion that the Court had "inherent" power to order liquidation, the learned Court below cited three cases: *Tower Hill-Connellsville Coke Co.* v. *Piedmont Coal Co.*, 64 F. 2nd 817 (C. C. A. 4th, 1933); *S. E. C.* v. *Fiscal Fund*, 48 F. Supp. 712 (D. Del., 1943); and *Dallasega* v. *Victoria Amusement Enterprises*, 43 F. Supp. 697 (M. D. Pa., 1943).

The *Fiscal Fund* case was *sui generis*. Fiscal Fund was a management investment company. It was, in turn, managed by another company which, for a stated fee, furnished Fiscal Fund with all services, including management, investment advice and clerical assistance. The management contract had expired and there was no one to renew it, or perform this service. Four of the five directors had resigned and the fifth was with the Armed Forces overseas. The shares issued by Fiscal Fund were redeemable upon application to a custodian, which, upon receipt of a certificate signed by two of Fiscal's officers, would raise the necessary money by selling securities held by it for Fiscal Fund. All requests for redemption were being

dishonored by the custodian because it had no cash, and Fiscal Fund had no management to make the sales itself or officers to sign the necessary authorization certificates. The S. E. C. had attempted to have interested parties effect a reorganization but without success. A temporary, and later a permanent, receiver of the company had been appointed. Not only was the machinery for redemption of securities indefinitely suspended, but thirteen other serious, permanent, continuing and irremediable defaults created what the Court termed "a complete collapse of Fiscal Fund's structure". Said the Court (p. 715):

> "* * * it is barely possible to detect the faint beating of the corporate pulse * * * and failure of corporate purpose is permanent and irremediable".

Elsewhere the Court said (p. 715):

> "I can see no substantial hope of ever reviving this business. It cannot continue to function under its present set up".

Furthermore, in the *Fiscal Fund* case there was no opposition to liquidation; neither the corporation nor any security holder ever entered an appearance; there was a complete and permanent suspension of corporate management and function, and no course except liquidation was open. It was in these circumstances, referred to by the Court as "the particular circumstances of this case", that the Court directed liquidation because (at p. 715)

> "It would be a palpable injustice to the stockholders not to take immediate steps looking to a refund of their investment".

That case was, as previously stated, *sui generis*.

In the *Tower Hill case* (64 F. 2nd 817; C. C. A. 4th, 1933) an order appointing receivers to liquidate was affirmed, it

having been shown that the owners of worthless common stock, who controlled the management, were ruthlessly dissipating the assets of the corporation to destroy the value of the preferred stock for their own collateral interests. It was, as Judge Chesnut described it in *Wall & Beaver Street Corporation* v. *Munson Line*, 58 F. Supp. 101, 108 (D. Md., 1944), "an exceptional and extraordinary case". Even in the *Tower Hill* case the Court recognized (p. 826) that:

> "The general rule undoubtedly is that courts of equity have no power to wind up a corporation, in the absence of statutory authority."

The power of a Court of Equity to order liquidation does not appear to have been questioned in the *Dallasega* case (43 F. Supp. 697; M. D. Pa., 1942). The question contested was whether or not a *Pennsylvania* Court could order liquidation of a *Delaware* corporation.

Of the foregoing three cases relied on by the learned Court below, only the *Fiscal Fund* case arose under the Act; the other two did not arise, as the present one does, under a statute which creates the right to sue and specifies a particular remdey.

The learned Court below also referred to 16 Fletcher, Cyc. of Corporations (1942) §8082 and to an article by Hornstein in 40 Columbia Law Review 220.

Fletcher supports our contention. He says (Sec. 8098, p. 828):

> "It is well settled as a general principle that unless jurisdiction is confirmed by statute Courts of Equity have no jurisdiction to decree a dissolution of a corporation"

and (p. 831)

> "*A fortiori*, a Court of Equity cannot dissolve a corporation where there is other statutory procedure provided for".

As far as Hornstein is concerned, it would seem that the learned Court below *misread* his article. Hornstein says (40 Columbia Law Review, p. 220):

> "Until fifty years ago, the uniformly accepted principle was, that, *in the absence of statute, a Court has no power to decree the winding up of a corporation* at the suit of a minority stockholder. *Many writers* (3 Cook on Corporations, 8th Ed. Sec. 629, 16 Fletcher 8080, 8098, Pomeroy Equity 4th Ed. 1540, 8 Thompson on Corporations, 3rd Ed. Sec. 6465) *still declare this to be the rule and describe a few contrary cases as exceptions to it.*" (Italics ours.)

Hornstein disagrees with this rule and says there has been a change in it in some jurisdictions, but in a footnote he points out (p. 223)

> "An analysis of the decisions indicates that *the old rule was applied and apparently still prevails in* California, Colorado, Illinois, Maryland, *Massachusetts,* Nebraska, Ohio, South Dakota and Utah. Missouri Courts are still vacillating and a few jurisdictions have not passed upon the question". (Italics ours.)

Thus, even according to Hornstein, the "old rule", the rule that Courts have no power to decree liquidation in the absence of statute, is still the law in Massachusetts, where this Trust was created and this case arose.

The following quotation from *Wallace* v. *Pierce-Wallace Pub. Co.*, 101, Iowa, 313, cited with approval in *Myers* v. *Occidental Oil Corp.*, 288 Fed. 997, 1003 (1923) states what we believe to be the rule:

> "It is certainly true that in the absence of express statutory authority, jurisdiction of courts of equity does not exist over corporate bodies to such an extent

as to justify them in dissolving corporations or in winding up their affairs and sequestering their property. This seems to be so well settled that there is scarcely a dissenting voice in authority."

A fortiori, we submit, where a statute, as in the case of the Act here involved, creates the right to sue and fixes a remedy *other* than liquidation.

However, irrespective of what may be the "general equity power" of the Court to order liquidation in the absence of statutory provision one way or the other, we submit that where Congress creates a regulatory agency, and expressly confers upon the Court the power to decree liquidation at its behest in two specified cases, as it did in the Investment Company Act, the power to liquidate does not exist in other cases arising under the statute. The specification of the power in specific instances is a negation of the power in others. *A fortiori* where a different remedy is expressly provided in such other cases. In such a situation there is no room for the supposition that the grant of power to liquidate in the other cases was inadvertently overlooked, or that it was left to inference, or to "general equity power".

POINT II.

Even if Congress had conferred the power to liquidate, it was error to order liquidation here because the management, for whose faithlessness receivers were appointed, has been ousted, the Trust is amply solvent, and the stockholders are prepared to elect honest and competent management.

The learned Court below, in support of its conclusion that the order of liquidation was proper, expressed the opinion that Aldred's solvency is "perhaps temporary".

It should be noted at the outset that the financial condition of Aldred cannot be made the basis of any judgment in this proceeding. The S. E. C. is not empowered to bring proceedings merely because of the financial condition of a corporation. That, in a proper case, is the province of others in a different type of proceeding. This was recognized by the S. E. C. in bringing this proceeding on the ground that the management was guilty of "gross misconduct and gross abuse of trust" (Complaint, ¶40, R. 9). Although the petition alleges insolvency, this allegation was relevant only as bearing on the effect of the misconduct and abuse of trust by Hanlon and his associates (Act. Sec. 36).

Since, however, the Court below has based its affirmance, at least in part, upon the statement that Aldred's solvency is "perhaps temporary", it is appropriate to point out that the Trust has $8,590,750.05 in cash and marketable securities (R. 125) whereas its only obligations are $5,900,000 in debentures, and the expenses of this proceeding. Even if these expenses will reach the unprecedented total of $250,000, there will be an excess of assets over liabilities of between $2,000,000 and $2,500,000—enough to pay the interest on the debentures for almost ten years, even if the $8,500,000 of assets should lie idle and earn not a cent throughout that entire period.

However, as previously stated, S. E. C. has no jurisdiction to sue, and did not assume to sue, because of Aldred's financial condition, and Aldred's financial condition may not be made the basis of judgment in this case. The action was brought, and receivership was sought, because of the necessity of taking Aldred's assets out of the control of men who had been guilty of "gross misconduct and gross abuse of trust" (Sec. 36). These faithless officials have now been removed, and the stockholders are prepared to furnish to the Trust a management composed of persons

whose character, skill, experience and responsibility are not questioned (R. 63, 70-72). The learned Court below brushed aside this circumstance as not "important", and yet it justifies the order of liquidation on the ground that "nothing would prevent" the new management from "embarking on new speculations to the detriment of the debenture holders". Persons who invest in 4½% debentures of an Investment Trust do not expect their money to lie idle. They expect the management of the Trust to invest it in securities. If the management is honest and capable, liquidation may not be ordered on the theory that at some future time some of the investments may prove unwise.

It is a firmly established rule that a Court of Equity will not decree the liquidation of a company whose assets are not in danger of dissipation through fraud or mismanagement. The reason of the rule is obvious: liquidation is an extreme and drastic measure which a court may order only for a company in desperate straits. If a company has proper management, the court may not, upon application of the S. E. C., substitute its judgment as to the disposition of the corporate assets for that of the persons who own the company and are lawfully entitled to operate it. *McQuillen* v. *National Cash Register Co.*, 112 F. (2d) 877 (C. C. A. 4th, 1940), cert. den. 311 U. S. 695 (1940); *Carson* v. *Allegany Window Glass Co.*, 189 Fed. 791 (C. Ct. Del., 1911); *Brictson Mfg. Co.* v. *Close*, 280 Fed. 297 (C. C. A. 8th, 1922); *Wall & Beaver St. Corp.* v. *Munson Line*, 58 F. Supp. 109 (D. Md., 1944); *Cook* v. *Cook*, 270 Mass. 534, 545, 170 N. E. 455 (1930); *Fletcher, Cyc. Corp.*, Vol. XIII, Sec. 5821.

In *Orth* v. *Transit Investment Corp.*, 132 F. (2d) 938 (C. C. A. 3rd, 1942), the power of a federal court of equity to order the liquidation of a solvent company was squarely in issue. The District Court had appointed receivers to liquidate and distribute the assets of the corporation, upon

a stockholder's bill alleging that the assets were threatened with dissipation through the fraud and mismanagement of the officers. The Circuit Court ordered the receivers discharged, holding that while the appointment of receivers to conserve the assets pending the appointment of competent directors was justified, the appointment of a receiver to liquidate was error. To permit such a liquidation, the Court said, would be to circumvent the laws of the State of Pennsylvania, which provide for the liquidation of corporations in certain specified ways and only under specified circumstances. Furthermore, the Court said, to permit liquidation would defeat rights established under the corporate charter.

Here too, the order of liquidation destroys rights created by Aldred's "charter" (Agreement and Declarations of Trust, Art. 12), which provides that the Trust shall not be terminated before the end of seventy-five years from the date of the trust agreement or twenty-one years after the expiration of specified lives in being, except by the unanimous approval of all the trustees. And here, as in Pennsylvania, the statutes prescribe the manner in which companies may be liquidated. Trust companies and banks may be liquidated, with the approval of the Commissioner of Banking, if authorized by a vote passed at a meeting specially called for that purpose. Mass. Laws, Ch. 167, Sec. 22. General business corporations may be liquidated under Ch. 155, Secs. 50 and 50A.

Liquidation of corporations by judicial decree is not contemplated by Massachusetts law, save possibly under most extraordinary circumstances. The leading case is *Cook* v. *Cook*, 270 Mass. 534, 170 N. E. 455 (1930), which arose on a bill, *inter alia*, for the appointment of a liquidating receiver. The Court held (p. 541-542):

> "Another contention of the plaintiffs is that a receiver should be appointed to wind up the affairs of

the corporation and distribute its assets to the stockholders. A business corporation may be dissolved under G. L. c. 155, sec. 50, as amended by St. 1928, c. 50, by vote of the majority of its stock and upon petition to the court. * * * The statute was not passed for the purpose of ordering the dissolution of a prosperous corporation, where its affairs are wisely administered and it is conducting an established and well known business, merely because of a disagreement between the present stockholders, and where it is not shown there is no way open to the parties 'of reaching an agreement and breaking such deadlock'."

* * * * *

"The defendant corporation is solvent. There is no necessity of such an appointment to preserve the assets of the corporation" (p. 543).

In *Cunningham* v. *Commissioner of Banks*, 249 Mass. 401, 144 N. E. 447 (1924), the Court said:

"It may be assumed that a trust company being liquidated by the commissioner of banks under this section [Ch. 167, sec. 22] is insolvent."

See also *Hurley* v. *Boston R. Holding Co.*, 315 Mass. 591, 54 N. E. (2d) 183 (1944); *Bleck* v. *East Boston Co.*, 302 Mass. 127, 18 N. E. (2d) 536 (1939); *Falmouth Nat'l Bank* v. *Cape Cod Ship Canal Co.*, 166 Mass. 550, 44 N. E. 617 (1896); *New England Theatres, Inc.* v. *Olympic Theatres, Inc.*, 287 Mass. 485, 192 N. E. 93 (1934); *Richardson* v. *Clinton Wall Trunk Mfg. Co.*, 181 Mass. 580, 64 N. E. 400 (1902); *Leventhal* v. *Atlantic Fin. Corp.*, 316 Mass. 194, 55 N. E. (2d) 20 (1944).

The Massachusetts Courts, in their refusal to order the liquidation of solvent companies, merely follow the universally recognized rule.

Edison v. *Edison United Phonograph Co.*, 52 N. J. Eq. 620, 29 Atl. 195 (1894);
Howze, et al. v. *Harrison*, 165 Ala. 150, 51 So. 614 (1910);
Boothe v. *Summit Coal Mining Co.*, 63 Wash. 630, 116 Pac. 269 (1911);
Forquer v. *Inland Finance Co.*, 142 Wash. 688, 253 Pac. 1086 (1927);
Webber v. *Minner*, 184 Mich. 112, 150 N. W. 305 (1915);
Furrer v. *Nebraska Bldg. & Inv. Co.*, 108 Neb. 698, 189 N. W. 359 (1922);
Radford West End Land Co. v. *Cowan*, 101 Va. 632, 44 S. E. 753 (1903);
South Norfolk Land Co. v. *Tibault*, 124 Va. 667, 98 S. E. 679 (1919);
Inscho v. *Mid-Continent Developing Co.*, 94 Kan. 370, 146 Pac. 1014 (1915);
Duncan v. *Treadwell Co.*, 82 Hun (N. Y.) 376, 31 N. Y. S. 340 (1894);
Ferry v. *Bank of Central New York*, 15 How. Pr. 445 (1858);
Trade Auxiliary Co. v. *Vickers*, 16 Eq. Cas. (L. R.) 303 (1873).

Even where no question of power was involved, Federal courts have consistently refused to order the liquidation of solvent companies except in extraordinary cases in which it was the only remedy possible to preserve the property rights of creditors and stockholders.

In *Orth* v. *Transit Inv. Corp.*, 132 F. (2d) 938 (C. C. A. 3rd, 1942), the court, in view of the solvency of the cor-

poration and its ability to carry on its business, reversed an order of liquidation and discharged the receivers.

In *Hutchinson* v. *Fidelity Ins. Ass'n*, 106 F. (2d) 431 (C. C. A. 4th, 1939), the court affirmed the trial court's refusal to appoint a liquidating receiver for an investment association found by a special master to be solvent. In *Sellman* v. *German Union Fire Ins. Co.*, 184 Fed. 977 (C. Ct. Del., 1909) the court denied an application for the appointment of a liquidating receiver because there was no conclusive showing of insolvency or of a failure of corporate purpose.

In *Wall & Beaver St. Corp.* v. *Munson Line*, 58 F. Supp. 101 (D. Md., 1944), the court, after stating facts showing that certain investments were the result of poor judgment and would probably cause loss to the corporation, said (p. 105):

> "*But there is no averment of anything like insolvency of the corporation*" (Court's italics).

And since the facts did not show a fraudulent effort to destroy the rights of senior interests, the court dismissed a bill in equity seeking liquidation.

Indeed, liquidation is deemed such an extraordinary, last-resort remedy that it will not be decreed even of an *insolvent* corporation, unless its prospects are so dismal that no other remedy will suffice.

> *Pennsylvania Steel Co.* v. *N. Y. Central R. Co.*, 198 Fed. 721, 737 (C. C. A. 2nd, 1912);
> *Bibber-White Co.* v. *White River Valley E. R. Co.*, 110 Fed. 473 (Cir. Ct. Vt., 1901);
> *In re Desrochers*, 183 Fed. 991 (D. Ct. N. Y., 1911);
> *In re Harris*, 156 Fed. 875 (S. Ct. Ala., 1907).

Courts have occasionally intervened to order liquidation where the corporate purpose had clearly become impossible of fulfillment. But short of that, a court does not order the death of a trust or corporation. As Circuit Judge Julius M. Mayer said (*Lectures on Legal Topics*, Vol. VI, pp. 161, 165, 167):

> "The underlying thought, the compelling motive of equity receiverships is to save the business. * * * In the case of commercial businesses which are faced with difficulties that seem temporary, and that require only careful handling, those who desire an equity receivership have in mind that at the end of that receivership there shall be a reconstructed and saved business. * * * It is the method openly adopted by which the estate is placed in the hands of the court, so that the court may hold out its protecting arm and preserve that estate until such time as it may properly be returned to its owners."

Aldred is today a solvent organization, with every likelihood of profitable and beneficial operations throughout the foreseeable future. The evils which brought it into court initially have disappeared or been removed. It is solvent in every sense of that word, with assets in excess of $8,500,000 and an indebtedness of $5,900,000, and with more than sufficient cash to meet current and future claims against it (R. 125-126). The management found guilty of a gross abuse of trust no longer has any connection with the Trust and would, upon termination of the receivership, be replaced by honest and skilled officers and directors (R. 70-72). It is significant that this last statement has never been challenged in these proceedings.

Here every opportunity exists for the fulfillment of the purpose for which Aldred was created. There is not a single creditor or security holder whose interests require

liquidation. It is true, as the Court below stated, that "no dissenting voice" has arisen to the order of liquidation from the debenture holders. That however does not mean that the debenture holders, or any substantial part of them, want liquidation. The truth is that they have had no opportunity to express themselves on the subject. Although a Committee purporting to represent debenture holders appeared in the proceeding, it has never disclosed whom it represents or how extensive is the representation. On the other hand, when petitioners sought an order to hold a special meeting of security holders, so that their views might be ascertained, the District Court denied the application. Without the Court's direction no such meeting could be called because the receivers alone had a list of the security holders, and the receivers refused to call the meeting (R. 57).

The equity of the stockholders in Aldred is between $2,000,000 and $2,500,000. Petitioners own 65% of the stock. They do not wish liquidation, and no other stockholder has asked for liquidation. The debenture holders have not been consulted. We submit that a highly solvent trust, to which reputable and competent management is available, should not be liquidated by judicial decree in such circumstances, even if power exists to compel liquidation in a proper case. The learned Court below answers that if petitioners wish to invest in an Investment Trust, they can form a new one, but it would be "inequitable" to allow them to "force those with burnt fingers to remain investors in an enterprise of proven questionable value". The only respect in which there is any justification for referring to "burnt fingers" and "proven questionable value" is the violation of trust by Hanlon and his associates. This condition, however, has been completely removed and corrected. Hanlon and his associates have been ousted; they have no further connection with the

Trust, and the stockholders are prepared, if permitted to meet, to elect new management as to whose ability and honesty there is no dispute. Breach of trust by a former management is no reason for decreeing the liquidation of a Trust, and this is expressly recognized by Section 36 of the Act, which provides that the remedy in such a case shall be an injunction against further participation by those who have been found recreant to the Trust. Nor is there any question here of "forcing" anyone to do anything. It is merely a question of permitting the owners of a fund to direct its destiny in the manner provided in the agreement under which they created it, there being no question of solvency and no dispute that competent and reputable hands are ready to take over.

The learned Court below acknowledged that this Trust, having been created prior to the Act, is not required to conform in its capital structure to the standards fixed by the Act for companies organized subsequent to the passage of the Act. The Court held, however, that when jurisdiction to appoint receivers attaches because of gross abuse of trust on the part of the trustees or officers, the fact that the trust does not conform to the standards laid down in the Act may make it "fair and equitable" to require the liquidation of the company. It is submitted that the learned Court of Appeals was in error in this view. The capital structure of this Trust is all that the law requires it to be, and furnishes no ground for its liquidation. No proceedings were, or could have been brought, on that ground. If former officers and trustees were guilty of gross abuse of trust, the remedy for that is their removal. That corrective remedy has been applied and enforced here by the removal of Hanlon and his associates.

POINT III.

Aldred was placed in receivership because its management was corrupt and wasteful. The reasons for which the receivership was required no longer exist. Since the trust now has available to it honest and capable management, the court should have terminated the receivership and restored the property to its owners.

The appointment of a receiver is always an ancillary and provisional remedy which affords no final relief and determines no substantive right. *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 497 (1923): *Orth* v. *Transit Investment Co.*, 132 F. (2d) 938, 945 (C. C. A. 3rd, 1942).

Consequently, when the object for which the receivership was created has been removed, the court which acquired possession of the property should discharge the receivers, terminate the receivership and return the property to its rightful owners. *Milwaukee & Minnesota R. Co.* v. *Soutter*, 69 U. S. 510 (1865); *Skirvin* v. *Mesta*, 141 F. (2d) 668 (C. C. A. 10th, 1944); *Sweet* v. *Continental-Leland Corp.*, 42 F. (2d) 382 (C. C. A. 6th, 1930); Pomeroy, Equity Jurisprudence (2d ed.), Vol. I, Sec. 171. Moreover, it should be terminated at the earliest practicable moment. *Mitchell* v. *Lay*, 60 F. (2d) 941 (C. C. A. 9th, 1932); *Von Boston* v. *United Rys. Co. of St. Louis*, 8 F. (2d) 826 (C. C. A. 8th, 1926), cert. den. 271 U. S. 665 (1926).

In the instant case the court had to appoint someone to manage the trust in the place of the directors and officers who were found guilty of a gross abuse of their trust. See *S. E. C.* v. *Aldred Investment Trust*, 58 F. Supp. 725 (D. Mass., 1945), aff'd 151 F. (2d) 254 (C. C. A. 1st, 1946), cert. den. 326 U. S. 795 (1946).

This reason no longer exists. Honest and competent management is now available (R. 70-72). In cases involving

identical questions Federal courts, in common with State courts, have always ordered the termination of the receivership.

In *Dold Packing Co.* v. *Doermann*, 293 Fed. 315 (C. C. A. 8th, 1923), officers and directors had mismanaged the company to further their own personal gain. The court for that reason appointed a receiver to operate the company. Two months later the dishonest management was replaced, and the Court promptly ordered the receivers discharged and the company's affairs restored to its stockholders. The Court said (at p. 332):

> "We think the position taken by the intervening stockholders was the right one. They insisted that when the receiver, within two months after his appointment, succeeded in removing the president of the company and his associates on the Board of Directors who had been utilizing the company for their personal advantage and benefit, the purposes for which the receivership was instituted had been accomplished, that there was nothing else that could be made the subject of judicial determination in the receivership cause; and that the receivership should be wound up and the company and its affairs restored to its stockholders.
>
> * * * * *
>
> "Property in receivership is in the custody of the court, and while the court may approve a reorganization of the business affairs of the property which it holds in receivership, made and agreed to by those who are interested in it, we do not understand that it is the duty or province of a court to take into its possession and hold the business affairs of others for the primary purpose of reorganizing that business. This record discloses that to be the remaining purpose

in the receivership cause, and however well the receiver might discharge the assumed duty, we think it properly belongs to the stockholders of the company, whose judgment ought to dictate what shall be done in that regard."

Fletcher, Cyclopedia of Corporations, Vol. XVI, Sec. 7770, citing *Edison* v. *Edison Phonograph Co.*, 52 N. J. Eq. 620, 626, says in this connection (p. 267):

"In case a receiver is appointed on the ground of lack of corporate officers or of dissension in the governing body making it impossible for the corporation to carry on the business with advantage to the stockholders, then the receivership must be only for such time as is necessary to protect the rights of the injured parties, and *as soon as a lawfully constituted and competent governing body comes into existence • • • the court must lift its hand and retire.*" (Italics ours.)

In *Sweet* v. *Continental-Leland Corp.*, 42 F. (2d) 382 (C. C. A. 6th, 1930) the Court stated that a receiver was properly appointed to preserve the assets of the corporation pending a determination as to which was the properly constituted board of directors. When that had been decided, the Court held, the receiver should be discharged and the property returned to its owners.

In *Brennan* v. *Rollman*, 151 Va. 715, 145 S. E. 260 (1928), the Court reviewed cases in many jurisdictions and concluded, on the basis of both equity and almost unanimous authority, that the argument against discharge of the receivers because of previous corrupt management

"is met, and we think successfully, by the fact that their influence in the control and policy of the company has passed to others who are independent of them or of their influence."

The only reason new officers and trustees have not been elected in the instant case is that the District Court has refused every request of the stockholders for permission to hold a meeting for that purpose (R. 165).

In *Skirvin* v. *Mesta*, 141 F. (2d) 668 (C. C. A. 10th, 1944), receivers were appointed for an insolvent company which owned several hotels. During the course of the receivership general business conditions, as in this case, improved to such a degree that the company became solvent anew. The Court ordered the receivership terminated and the property returned to the original management, and said (at p. 673):

> "The power to vacate an appointment improvidently made or to terminate a receivership no longer needed is a necessary incident to the power to appoint in the first instance. And where the appointment was not illegal but the reason or necessity for continuing it has ceased, the property should be discharged from the receivership and restored to its owners. *Milwaukee & M. R. Co.* v. *Soutter*, 69 U. S. 510, 2 Wall 510, 17 L. Ed. 900; *Wagoner Oil & Gas Co.* v. *Marlow*, 137 Okl. 116, 278 P. 294; * * *"

High on Receivers (4th Ed.), Sec. 841, says:

> "In passing upon an application for a receiver's discharge the court should have in view the interests of all parties, and if satisfied that the rights of all parties in interest will be best promoted by granting the discharge, it should be allowed. *Thus, when a receiver is appointed over a corporation, under a law of the state authorizing receivers of insolvent corporations, it is proper for the court to discharge him upon motion of defendant corporation, upon being satis-*

fied that it is in solvent circumstances and able to resume business, and that the interests of the creditors will be best secured by this course." (Italics ours.)

See also 53 Corp. Jur. 106 and cases there cited;

Beach: *Receivers* (Alderson Ed.) §421;
High: *Receivers*, §821;
Orth v. *Transit Investment Corp.*, 132 F. (2d) 938 (C. C. A. 3rd, 1942).

As an ancillary remedy, receivership may be continued only as long as there is need for the primary remedy. In this case the primary remedy was the injunction issued under Section 36 of the Investment Company Act for violation of that Section. The persons enjoined are no longer associated with Aldred. The necessity for the primary remedy has, therefore, terminated, and the ancillary remedy should terminate with it.

POINT IV.

The District Court erred in denying the motion for permission to call a special meeting of security holders.

Honest and skilled officers and trustees are immediately available; they have not already replaced the former corrupt management only because the District Court repeatedly denied the stockholders the right to call a special meeting for the purpose of electing new trustees (R. 52-67, 97-104, 115-124, 165).

Aldred's Agreement and Declaration of Trust, which establishes the rights of all parties to the trust, provides in Articles "Second" and "Eighth" that meetings of stockholders shall be held upon the demand of the holders of 25% of the Common Stock (R. 55).

Petitioners purchased the "Hanlon Stock" on January 15, 1946 (R. 53). They found that the Hanlon-designated

trustees had resigned progressively and had purportedly elected certain successors (R. 53). On January 23, 1946, in their desire to replace these purported Trustees with qualified persons unconnected with the Hanlon regime, they addressed a demand for the calling of a special meeting to the Receivers and to the purported Trustees (R. 67). The demand was in accordance with the appropriate provisions of the Agreement and Declaration of Trust. This demand was ignored by those to whom it was addressed. Petitioners were themselves powerless to call a meeting, since they had no list of security-holders and were denied access to any such list (R. 57, 98).

In this connection it is significant that representatives of the so-called "Bondholders Committee" were given free access to a list of security-holders, for the purpose of soliciting support for its own point of view. This charge was made in open Court by petitioners' counsel (R. 158), in the presence of counsel for the said committee and of the Receivers (R. 155, 156). It has never been contradicted.

When the demand for the calling of a special meeting was ignored, petitioners moved for leave to intervene (R. 50) upon a proposed pleading in which they besought the District Judge to order the holding of a meeting (R. 62). Upon the allowance of their motion to intervene, petitioners moved specifically for an order directing the calling of a meeting (R. 87). The District Judge held this motion under advisement from March 28, 1946 until May 8, 1946.

The District Judge indicated his intention to deny the motion on May 8, 1946, but withheld his decision at petitioners' request until June 5, 1946 (R. 165).

On that date the motion was denied on the grounds that there was no approved plan of reorganization to discuss with security-holders "and the election of trustees at this late date is deemed unnecessary and inadvisable since liquidation is about to commence" (R. 132). The reason

assigned by the District Court in June for denying the right to hold a meeting can hardly justify the failure to order a meeting prior thereto, when there was no prospect of immediate liquidation or reorganization.

In refusing to permit the requested meeting of stockholders, the Court defeated a substantial right created by the Indenture. This was in contravention of all established authorities, which hold that the stockholders' right to hold a meeting may not be defeated by the Court presiding over an equity receivership. And in denying petitioners access to the stockholders' list the District Court defeated petitioners' rights under the laws of the State of Massachusetts (Mass. Laws Ann., ch. 155, Sec. 22).

The precise question has been raised several times in the Circuit Court of Appeals for the Second Circuit. In *In re Bush Terminal Co.*, 78 F. (2d) 662 (C. C. A. 2nd, 1935), a petition of the debtor for reorganization under the Bankruptcy Act had been approved, and the president of the debtor (who was also a director and the largest stockholder) petitioned for the right to examine the stockholders' list for the purpose of calling a stockholders' meeting to elect a new board of directors. The District Court denied the petition. The Circuit Court of Appeals reversed, stating that the stockholders had the right to be represented by directors of their own choosing and that the possession of the property by a court of bankruptcy did not impair this right. The holding of the *Bush* case is peculiarly applicable to the facts of the case at bar, inasmuch as the present holders of a majority of the stock have never had the opportunity to elect trustees of their choice.

In re J. P. Linahan, Inc., 111 F. (2d) 590 (C. C. A. 2nd, 1940), involved the same issue, and again the Court sus-

tained the right of stockholders to meet to elect a new Board of Directors, stating (at p. 592):

> "As to such matters the right of the majority of stockholders to be represented by directors of their own choice and thus to control corporate policy is paramount and will not be disturbed unless a clear case of abuse is made out. This has been the rule all along in equity receivership, in ordinary bankruptcy and in proceedings for reorganization under former Section 77B of the Bankruptcy Act, 11 USCA Section 207, where the corporate property was in control of receivers or trustees."

The language of the Court makes it clear that the rule applies to equity receiverships as well as to reorganizations under the Bankruptcy Act. The case is even stronger for allowing stockholders' meetings to elect new directors (or trustees) in receiverships, because Section 2(15) of the Bankruptcy Act, 11 USCA Section 11(15) permits a court of bankruptcy to enjoin any action which would tend to defeat or impair its jurisdiction. Even this statutory grant of power, it was held in both the *Bush* and *Linahan* cases, cannot be used by the Court to defeat the right of stockholders to meet and select new directors.

An earlier case, *Graselli Chemical Co.* v. *Aetna Explosives Co. Inc.*, 252 Fed. 456 (C. C. A. 2nd, 1918), had cast some doubt on this principle. There, a corporation in receivership had been managed so efficiently by the receivers that a restoration of solvency was imminent. Due to a default in dividend payments, the preferred stockholders were temporarily given voting rights pursuant to the charter of the corporation, which allowed each preferred stockholder nine votes for each share of stock held. The preferred stockholders sought to take advantage of their overwhelming preponderance of votes by proposing a re-

organization plan which would have given them control of the corporation, and for this purpose sought to hold a stockholders' meeting at which they could elect a Board of Directors which would adopt their plan of reorganization. The common stockholders objected. The Court enjoined the stockholders' meeting on the ground that the common stockholders were the real owners of the corporation and should not be deprived of such ownership merely because of the temporary advantage given the preferred stockholders by the default in the payment of dividends. This decision was by a divided court and any doubts that its application might be more general have been laid at rest by subsequent decisions in the same court which have explicitly limited the *Graselli* case strictly to its particular facts [*Manhattan Rubber Manufacturing Co.* v. *Lucey Manufacturing Co.*, 5 F. (2d) 39, (C. C. A. 2nd, 1925)]. The comment of Judge Learned Hand in the *Manhattan Rubber* case is apposite:

> "As I understand it, the receivers support their position chiefly by an appeal to Graselli Chemical Co. v. Aetna Explosives Co., 252 F. 456 (C. C. A. 2) 164 C. C. A. 380. There it is true that by a divided court we held in a suit like this the preferred shareholders of a company in receivership might be enjoined from exercising rights given them under the charter. If the principles there enunciated were again to arise, for myself, I should feel it necessary to give the closest scrutiny to their validity and to consider in the gravest possible way whether the authority of the case must not be confined to the very facts then before the court. For that reason I am quite unwilling now by silence to give any apparent assent to its broader implications." • • •

The rule that stockholders may hold meetings although the property is in receivership has been sustained in every

jurisdiction in which the question has arisen. See *In re O'Gara Coal Co.*, 260 Fed. 742 (C. C. A. 7th, 1919); *Butler* v. *Beach*, 82 Conn. 417, 74 Atl. 748 (1909); *State* v. *Merchant*, 37 Ohio State 251; *Taylor* v. *Philadelphia R. R. Co.*, 7 Fed. 381 (C. Co. Pa., 1881); *Commonwealth* v. *Overholt*, 23 Pa. Sup. Ct. 199 (1902); *Lehigh Coal & Nav. Co.* v. *Central R. R. Co. of N. J.*, 35 N. J. Eq. 349 (1882). See also Fletcher, Cyclopedia of Corporations, Vol. 16, Sec. 7783.

The refusal of the learned District Judge to permit the calling of a meeting of security holders was highly prejudicial. It restricted any communication with the security holders to a self-constituted "bondholders committee" whose clients, and the extent of their holdings, were never disclosed, and whose interest was to compel liquidation or get control of the Trust despite any consideration of fairness to the stockholding group. The Court created a close monopoly over the list of the security holders and thereby over the means of communicating and consulting with them. This explains why the bondholders were not heard from, and is an answer to the learned Circuit Court's observation that "no dissenting voice" has come from the bondholders to the order of liquidation.

It is no answer to say, as the learned Court below did, that petitioners were accorded an opportunity to present their views in open Court and that the affairs of the Trust were administered by the receivers.

Whether in equity receivership or bankruptcy, the views and desires of all the security-holders of the trust or corporation whose property is being administered are an indispensable factor in any decision affecting the property. The Commission itself has stated that those views cannot be properly presented by directors or trustees not chosen by the holders of the majority of the outstanding stock. See *Securities and Exchange Commission, "Report on Protective And Reorganization Committees"*, Part VIII, 164-

177.* This report is a detailed and scholarly analysis of the inequities and abuses which result from "monopoly of (security-holders') lists", replete with references to the decided cases in which are set out the rights of security-holders to be informed and to have a voice in the disposition of their property rights. Vehemently and trenchantly, the Report condemns the exclusion of the security-holders from participation in the resolution of the company's fate. On this point, the Report refers to *Bergelt* v. *Roberts*, 144 Misc. (N. Y.) 832, 258 N. Y. Supp. 905; aff'd 236 App. Div. 777 (1932). In that case the Court condemned the refusal to make the list of bondholders available to other security holders who desired to effect "communication and conference among those having a community of interest."

The refusal to permit appellants to call a meeting to elect trustees and the failure to consider the wishes of the debenture-holders and shareholders resulted in the substitution of the Court's judgment for that of the owners of the Trust. But a receivership court does not exercise that responsibility, and may not assert that power. As Judge Learned Hand said in his concurring opinion in *Manhattan Rubber Manufacturing Co.* v. *Lucey Manufacturing Co.*, 5 F. (2d) 39 (C. C. A. 2nd, 1925), at p. 43:

> "We are asked to hold that such a suit [a creditor's bill in an equity receivership] submits the corporation generally to a visitatorial control, by virtue of which we can compel the debtor to do whatever may in our judgment be to the advantage of its creditors. Any

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* Ibid., Part I, page 456, says: "Suffice it to say here that • • • Provision must be made either to give security holders access to lists (subject to reasonable safeguards against the use of the names for improper purposes) or to provide machinery whereby the use, although not the physical possession of the list, is permitted them. These matters are of primary importance." See also Ibid. *supra*, Part I, pages 411-415, 897-903.

such notion ignores altogether the origin and history of such suits. They are as much limited by law as any others, and there is in my judgment no warrant either in principle or policy for asserting that, once a receiver is appointed, the court takes on the part of a benevolent despot. If we needed authority for so plain a proposition, it seems to me that there is the clearest intimation of it in Pusey & Jones v. Hanssen, supra."

In the circumstances of this case particularly—solvency and availability of honest and efficient management—the conduct of the District Judge in denying the motion to call a special meeting of security-holders, and in ordering liquidation without permitting the security-holders to be heard thereon, constituted substantial error.

CONCLUSION.

The petition for a writ of certiorari should be granted.

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